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19 **UNITED STATES BANKRUPTCY COURT**
20 **EASTERN DISTRICT OF CALIFORNIA**
21 **SACRAMENTO DIVISION**

22 In re:) Case No. 12-32118
23 CITY OF STOCKTON, CALIFORNIA,) D.C. No. JD-2
24 Debtor.) Chapter 9
25) **FRANKLIN'S REPLY IN**
26) **SUPPORT OF MOTION TO**
27) **ALTER AND AMEND FINDINGS**
28) **OF FACT AND CONCLUSIONS**
) **OF LAW REGARDING ALLOWED**
) **AMOUNT OF RETIREE HEALTH**
) **BENEFIT CLAIMS**
)
)
) Hearing: December 10, 2014
) Time: 11:00 a.m.
) Dept: C, Courtroom 35
) Judge: Hon. Christopher M. Klein

1 The City and the Committee concede that the Retiree Health Benefit Claims were not
 2 discounted to present value.¹ That fact alone establishes that the Court erred in concluding that the
 3 Retiree Health Benefit Claims should be allowed in the aggregate amount of \$545 million.
 4 Notwithstanding the attempted obfuscation and misdirection of the objectors, good cause exists for
 5 the Court to alter and amend that holding to reduce the allowed amount of those claims to their
 6 aggregate present value of \$261.9 million.

7 **No Impact On Retiree Distributions**

8 To start, Franklin reiterates that the relief sought in its Motion “will have absolutely no
 9 impact on retirees, whose treatment and distributions under the Plan will remain unchanged.”² The
 10 City’s assertion that the Motion “would result in each Retiree having a smaller claim amount, but
 11 Franklin having a greater share of payments to Class 12 unsecured creditors”³ is simply false, as is
 12 the Committee’s claim that discounting to present value “would unfairly discriminate against the
 13 retirees.”⁴

14 Rather, as the Committee confirms elsewhere,⁵ holders of Retiree Health Benefit Claims
 15 receive an aggregate of \$5.1 million under the Plan regardless of the amount of the Retiree Health
 16 Benefit Claims, whether they be allowed in an aggregate of \$545 million, \$261.9 million, or
 17 \$1 million. The distribution on Retiree Health Benefit Claims is simply not tied to the allowed
 18 amount in any way. Perversely, the allowed amount of those claims impacts only Franklin – the
 19 larger the allowed pool of Retiree Health Benefit Claims, the smaller the distribution on Franklin’s
 20 unsecured claim in Class 12 under the Plan (and, hence, the greater the savings to the City).⁶ The
 21 Committee has no legitimate interest in this issue.

22 ¹ City Obj. at 1 (“The City has never argued that the \$545 million amount reflected the present
 23 value of the Retiree Health Benefit Claims”); Committee Obj. at 3 (“the Retiree Health
 24 Benefit Claims . . . should be allowed as scheduled without any discounting to present value”).

25 ² Motion at 3.

26 ³ City Obj. at 2.

27 ⁴ Committee Obj. at 7.

28 ⁵ *Id.* at 6-7 (“The \$5.1 million payment is a fixed amount that would not be changed by the
 present value ruling.”); *see* Motion at 5 and n.5.

⁶ Motion at 5-6.

1 In fact, as made clear in the Motion, Franklin has no desire to alter any retiree’s respective
 2 entitlement to a *pro rata* share of the \$5.1 million promised by the City, and Franklin does not
 3 oppose the Committee’s suggestion “that any ruling on present value should be made in a manner
 4 that would not change the respective distributions to Retiree Health Benefit Claimants.”⁷ This
 5 gives the lie to the City’s assertion that Franklin should lodge “a formal objection” to each of
 6 the 1,100 individual Retiree Health Benefit Claims.⁸ As the City and the Committee concede, the
 7 parties stipulated that Franklin could raise the present value issue in connection with confirmation
 8 specifically “[i]n order to avoid the inefficiency, confusion and expense that would result from the
 9 prosecution of claim objections against approximately 1,100 individual Retiree Health Benefit
 10 Claimants.”⁹ Given that the relief requested would have no impact on those claimants, it would be
 11 pointless to do as the City suggests.

12 **No “Expert” Decision To Abandon Discounting To Present Value**

13 Implying that its decision not to discount the liability to present value is the result of expert
 14 judgment, the City also asserts that “[t]he Retiree Health Benefit Claims were calculated by The
 15 Segal Company, a company with unquestioned expertise in this area, . . . [and are] the product of a
 16 careful analysis by the actuaries at The Segal Company”¹⁰

17 In fact, however, Segal previously calculated the City’s liability for retiree health benefits
 18 for purposes of the City’s audited financial statements and, in doing so, discounted the liability to
 19 present value.¹¹ The only reason that Segal did not discount the Retiree Health Benefit Claims for
 20 purposes of the bankruptcy case was because the City “directed them not to do it.”¹² There is no
 21 evidence supporting the City’s decision to abandon its prior practice of discounting the liability to
 22 present value, and certainly no expert opinion that supports the City’s bankruptcy-driven change in
 23

24 ⁷ Committee Obj. at 7.

25 ⁸ City Obj. at 9.

26 ⁹ [DN 1356].

27 ¹⁰ City Obj. at 1.

28 ¹¹ Motion at 6-7.

¹² Motion, Ex. B. at 151 (5/14/14 Tr. at 19:17-18 (Goodrich)).

1 methodology. To the contrary, the evidence and expert testimony establishes that discounting is
2 required by the Governmental Standards Accounting Board and basic economic common sense.¹³

3 The City also claims that the \$261.9 million liability reflected in its audited financial
4 statements is “not a discount to present value of the \$545 million amount” to which it has
5 stipulated.¹⁴ That is a meaningless distinction. The trial record includes a breakdown of the year-
6 by-year health care liability amounts – from 2013 to 2095 – that the City added up to calculate the
7 \$545 million aggregate Retiree Health Benefit Claim amount.¹⁵ It is a matter of simple math to
8 discount those annual liabilities back to present value. Not coincidentally, using a discount rate
9 of 5% (the same rate used to discount future payments made to creditors under the Plan), those
10 future liabilities have a discounted present value of \$242.8 million¹⁶ – materially identical to
11 (actually \$19 million less than) the present value liability for retiree health care reflected in the
12 City’s audited financial statements.

13 **Persuasive Authority Establishes That The Claims Must Be Discounted To Present Value**

14 In the Motion, Franklin cited nine cases – including decisions from the Sixth and Tenth
15 Circuits – holding that claims for future liabilities must be discounted to present value for purposes
16 of allowance under the Bankruptcy Code.¹⁷ In the face of this compelling authority, the objectors
17 largely resort to empty criticism (“not persuasive,” “passing suggestions,” “low-grade precedents”)
18 and denigration of the courts that authorized those opinions (“uncareful language,” “wrongly
19 misapply Bankruptcy Code sections”).¹⁸

20 Those meaningless attacks aside, the objectors make four unconvincing arguments. **First**,
21 they argue that section 502(b) of the Bankruptcy Code forbids discounting because it “requires the
22 court to determine the ‘*amount*’ of a claim,” in contrast to other sections of the Code that “ask

23 ¹³ Motion at 6-7.

24 ¹⁴ City Obj. at 8.

25 ¹⁵ *Direct Testimony Declaration Of Teresia Zadroga-Haase* [DN 1385], Ex. A (copy attached as Exhibit A).

26 ¹⁶ See the calculations appended to this Reply.

27 ¹⁷ Motion at 7-10.

28 ¹⁸ City Obj. at 4, 5; Committee Obj. at 5.

1 courts to ‘determine the *value*’ as of a specific date.”¹⁹ This is a nonsensical apples-to-oranges
2 comparison. Each of the statutory sections cited by the objectors concerns the value of property
3 distributed by the debtor or the estate. In those instances, Congress spoke of the present “value” of
4 the property to be distributed. In contrast, section 502 of the Code involves claims asserted against
5 the debtor or the estate. In the context of claim allowance, it makes little sense to speak of the
6 “value” of a debtor’s liabilities. Rather, Congress properly directed courts to determine the
7 “amount” of the liabilities that may be allowed against the bankruptcy estate.

8 Here, the “amount” of the Retiree Health Benefit Claims is the City’s projected expense of
9 providing health care benefits through the year 2095, discounted to account for the fact that the City
10 would not have incurred much of that expense until decades into the future. That is the liability
11 reflected in the City’s financial statements and it is the most that retirees could have recovered had
12 they obtained a judgment against the City on the bankruptcy petition date. The City’s assertion that
13 “the Bankruptcy Code accelerates the maturity of future obligations to the petition date” proves too
14 much.²⁰ As the legislative history cited by the City makes clear, a bankruptcy petition “operates as
15 the acceleration of the principal amount of all claims against the debtor.”²¹ There is no “principal
16 amount” of the Retiree Health Benefit Claims, and there is nothing to accelerate. In litigation on
17 their claims, retirees would have received no more than an amount equal to that needed to buy an
18 annuity or insurance premium for lifetime health care, something that obviously could be obtained
19 for a fraction of the projected non-discounted cost of healthcare expenses that would not be incurred
20 until decades into the future.

21 There simply is nothing in the Bankruptcy Code that prohibits the discounting of a claim
22 against the estate. In fact, the objectors’ marquee authority – *Oakwood Homes* – directly
23 contradicts the objectors on this very point. In that case, the Third Circuit specifically rejected the
24 argument that the Code forbids the discounting of a claim based upon future liabilities of the debtor:

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26 ¹⁹ City Obj. at 2 (emphasis in original); see Committee Obj. at 3.

27 ²⁰ City Obj. at 3.

28 ²¹ *Id.* (quoting H.R. Rep. 95-595 at 353-54 (1977)) (emphasis added).

1 We do not hold here that 11 U.S.C. § 502(b) never authorizes discounting
 2 a claim to present value, but instead that the statute does not clearly and
 3 unambiguously require it for all claims evaluated under § 502. In general,
 4 we of course acknowledge that money received today is more valuable
 5 than money negotiated to be received in the future, and reduction in
 6 recognition of that basic economic fact may sometimes be appropriate.

7 *In re Oakwood Homes Corp.*, 449 F.3d 588, 598 (3d Cir. 2006) (emphasis added).²² Rejecting the
 8 exact argument made by the City, the Circuit noted that “finding a statute does not clearly and
 9 unambiguously order action X does not necessarily lead to the conclusion that action X is
 10 inappropriate – merely that further inquiry into other sources is needed.” *Id.* at 598 n.11.

11 **Second**, the City argues that discounting future liabilities to present value would render
 12 various subsections of section 502(b) “superfluous.”²³ This too makes no sense. Aside from
 13 section 502(b)(2)’s disallowance of “unmatured interest” (addressed below), the other subsections
 14 of section 502(b) cited by the City have nothing to do with discounting claims to present value.
 15 They are intended to accomplish policy objectives of ensuring that landlords and employees are not
 16 overcompensated by allowance of claims based on contracts that provide payments over long
 17 periods of time despite the lack of any continuing benefits to the estate – hence, the limitation of
 18 landlord claims to a maximum of three years’ of future rent and the limitation of employee claims
 19 to a maximum of one year of future compensation. 11 U.S.C. §§ 502(b)(6), (7).

20 Here again, *Oakwood Homes* directly contradicts the position advanced by the objectors. In
 21 *Oakwood*, the Third Circuit surveyed the same subsections of section 502(b) but reached precisely
 22 the opposite conclusion than the one urged by the objectors: “We wholeheartedly agree that future
 23 liabilities must be reduced in some way to reflect the time value of money.” *Oakwood Homes*, 449
 24 F.3d at 601 (emphasis added).

25 **Third**, the objectors try but fail to distinguish the numerous cases cited by Franklin that
 26 mandate the discounting of claims for future liabilities.²⁴

27 ²² The only other case relied upon by the objectors quotes this passage with approval. *In re*
 28 *Gretag Imaging, Inc.*, 485 B.R. 39, 46 (Bankr. D. Mass. 2013) (quoting *Oakwood Homes*).

²³ City Obj. at 3.

²⁴ City Obj. at 4-6; Committee Obj. at 5-6.

1 For example, the City acknowledges that the “ERISA cases” cited by Franklin “contain
2 passing suggestions, without the benefit of statutory or doctrinal analysis, that the Bankruptcy Code
3 provides for such discounting to present value,” but then urges that “this language is clearly *dicta*”
4 because “ERISA mandated the discount to present value.”²⁵ The City is wrong. The Sixth and
5 Tenth Circuits made much more than “passing suggestions” in *dicta* – they specifically held in clear
6 and unambiguous language that the Code requires discounting of claims for future pension benefits.
7 *In re CSC Indus. Inc.*, 232 F.3d 505, 508 (6th Cir. 2000) (citing section 502(b) for the proposition
8 that “the bankruptcy court must . . . reduce claims for future payment to present value”) (emphasis
9 added); *In re CF&I Fabricators of Utah, Inc.*, 150 F.3d 1293, 1300 (10th Cir. 1998) (citing
10 section 502(b) for the proposition that, “[t]o insure the relative equality of payment between claims
11 that mature in the future and claims that can be paid on the date of bankruptcy, the Bankruptcy
12 Code mandates that all claims for future payment must be reduced to present value”) (emphasis
13 added); *see also In re Chateaugay Corp.*, 115 B.R. 760, 770 (Bankr. S.D.N.Y. 1990) (“Once the
14 value of the aggregate future liabilities has been determined, the present value of those future
15 liabilities is determined as a matter of bankruptcy law so that all similar claims for future liabilities
16 are treated in an economically similar manner.”) (emphasis added), *vacated by consent order*, 1993
17 U.S. Dist. LEXIS 21409 (S.D.N.Y. June 7, 1993).

18 Those are not “cherry-picked quotations.” They are core holdings of two different Circuit
19 Courts. The fact that those cases involved disputes over the appropriate discount rate does not
20 render those core holdings *dicta*. The discount rate never would have been at issue if the
21 Bankruptcy Code did not require discounting of the claims. Moreover, the provisions of ERISA
22 relating to discounting are analogous to the rules of the Governmental Standards Accounting Board
23 that require the City to discount its retiree health liability for purposes of its audited financial
24 statements. In each case, the non-bankruptcy rule provides guidance with respect to calculation of a
25 liability for which the Bankruptcy Code requires discounting.

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27 _____
28 ²⁵ City Obj. at 4.

1 Notably, the objectors do not even attempt to distinguish Franklin’s multiple other
2 authorities, which mandate discounting of claims for deferred compensation (*Kucin, Trace,*
3 *Thomson McKinnon*), installment payments under a lease (*O.P.M.*), and non-interest bearing notes
4 (*Wisconsin Engine, Loewen*).²⁶ All of these cases are persuasive, indeed compelling, authority
5 independently establishing that claims based upon a debtor’s future liabilities – like the Retiree
6 Health Benefit Claims – must be discounted to present value for purposes of allowance and
7 distribution.

8 **Fourth**, and finally, the objectors continue to rely on *Oakwood Homes*.²⁷ However, as
9 explained at length in the Motion and as noted above, *Oakwood* is fully consistent with the
10 Bankruptcy Code’s mandate that the Retiree Health Benefit Claims be discounted. Among other
11 things, the holding of *Oakwood* was expressly based on the difference between interest-bearing and
12 non-interest bearing obligations. The Third Circuit held that the former are not to be discounted
13 because section 502(b)(2) already discounts the claim by disallowing unmatured interest on the
14 obligation. In contrast, the Circuit held that the latter – non-interest bearing claims like the Retiree
15 Health Benefit Claims – must be discounted in order to “avoid[] a windfall.” *Oakwood Homes*, 449
16 F.3d at 601. The City asserts that “there is no reason why the statutory interpretation and analysis
17 of the Third Circuit would, or should, be any different in a case where unmatured interest was not
18 involved,” blithely ignoring that the Circuit specifically drew just such a distinction and concluded
19 “that future liabilities must be reduced in some way to reflect the time value of money.” *Id.*
20 (emphasis added).

21 The Committee also argues that it would be unfair to discount the Retiree Health Benefit
22 Claims because “Franklin’s own general unsecured claim . . . has not been discounted to present
23 value.”²⁸ But it has. The entirety of Franklin’s claim for interest to be paid over the next three
24 decades has been disallowed. If Franklin’s claim were treated like the Retiree Health Benefit
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26 ²⁶ See Motion at 8-10.

27 ²⁷ City Obj. at 6-8; Committee Obj. at 3-4.

28 ²⁸ Committee Obj. at 4.

AppendixPresent Value Of Projected Retiree Health Benefit Expenses

5% Discount Rate

	<u>Date</u>	<u>Expense</u>	<u>Time</u>	<u>Discount</u>	<u>Present Value</u>
1					
2					
3					
4	2013	\$14,919,712	2.00	1.103	\$13,532,619
5	2014	\$15,555,962	3.00	1.158	\$13,437,825
6	2015	\$16,038,883	4.00	1.216	\$13,195,229
7	2016	\$16,513,171	5.00	1.276	\$12,938,502
8	2017	\$16,854,112	6.00	1.340	\$12,576,798
9	2018	\$17,040,154	7.00	1.407	\$12,110,119
10	2019	\$17,026,612	8.00	1.477	\$11,524,281
11	2020	\$17,041,141	9.00	1.551	\$10,984,871
12	2021	\$17,111,465	10.00	1.629	\$10,504,955
13	2022	\$16,734,478	11.00	1.710	\$9,784,303
14	2023	\$16,591,229	12.00	1.796	\$9,238,617
15	2024	\$16,255,928	13.00	1.886	\$8,620,866
16	2025	\$16,296,902	14.00	1.980	\$8,231,043
17	2026	\$16,128,568	15.00	2.079	\$7,758,117
18	2027	\$15,560,288	16.00	2.183	\$7,128,347
19	2028	\$15,312,676	17.00	2.292	\$6,680,870
20	2029	\$15,325,322	18.00	2.407	\$6,367,988
21	2030	\$15,230,484	19.00	2.527	\$6,027,220
22	2031	\$15,120,823	20.00	2.653	\$5,698,879
23	2032	\$14,970,506	21.00	2.786	\$5,373,549
24	2033	\$14,819,087	22.00	2.925	\$5,065,903
25	2034	\$14,556,248	23.00	3.072	\$4,739,097
26	2035	\$14,283,793	24.00	3.225	\$4,428,946
27	2036	\$13,918,697	25.00	3.386	\$4,110,230
28	2037	\$13,452,091	26.00	3.556	\$3,783,276
29	2038	\$12,904,248	27.00	3.733	\$3,456,381
30	2039	\$12,334,811	28.00	3.920	\$3,146,532
31	2040	\$11,705,505	29.00	4.116	\$2,843,809
32	2041	\$11,004,864	30.00	4.322	\$2,546,277
33	2042	\$10,300,600	31.00	4.538	\$2,269,835
34	2043	\$9,634,319	32.00	4.765	\$2,021,918
35	2044	\$8,951,554	33.00	5.003	\$1,789,170
36	2045	\$8,287,777	34.00	5.253	\$1,577,618
37	2046	\$7,609,337	35.00	5.516	\$1,379,499
38	2047	\$6,946,526	36.00	5.792	\$1,199,369
39	2048	\$6,324,907	37.00	6.081	\$1,040,040
40	2049	\$5,733,526	38.00	6.385	\$897,901
41	2050	\$5,166,114	39.00	6.705	\$770,515
42	2051	\$4,634,923	40.00	7.040	\$658,371
43	2052	\$4,142,114	41.00	7.392	\$560,352
44	2053	\$3,689,097	42.00	7.762	\$475,302
45	2054	\$3,275,243	43.00	8.150	\$401,887
46	2055	\$2,899,180	44.00	8.557	\$338,802
47	2056	\$2,559,343	45.00	8.985	\$284,846
48	2057	\$2,254,005	46.00	9.434	\$238,917
49	2058	\$1,979,573	47.00	9.906	\$199,836
50	2059	\$1,731,965	48.00	10.401	\$166,515

	<u>Date</u>	<u>Expense</u>	<u>Time</u>	<u>Discount</u>	<u>Present Value</u>
1	2060	\$1,508,624	49.00	10.921	\$138,136
2	2061	\$1,306,952	50.00	11.467	\$113,971
	2062	\$1,125,615	51.00	12.041	\$93,484
3	2063	\$962,940	52.00	12.643	\$76,165
	2064	\$817,306	53.00	13.275	\$61,568
4	2065	\$687,765	54.00	13.939	\$49,342
	2066	\$573,600	55.00	14.636	\$39,192
5	2067	\$473,908	56.00	15.367	\$30,839
	2068	\$387,718	57.00	16.136	\$24,028
6	2069	\$313,966	58.00	16.943	\$18,531
	2070	\$251,537	59.00	17.790	\$14,139
7	2071	\$199,225	60.00	18.679	\$10,666
	2072	\$155,838	61.00	19.613	\$7,946
8	2073	\$120,246	62.00	20.594	\$5,839
	2074	\$91,420	63.00	21.623	\$4,228
9	2075	\$68,416	64.00	22.705	\$3,013
	2076	\$50,372	65.00	23.840	\$2,113
10	2077	\$36,484	66.00	25.032	\$1,458
	2078	\$26,002	67.00	26.283	\$989
11	2079	\$18,237	68.00	27.598	\$661
	2080	\$12,584	69.00	28.978	\$434
12	2081	\$8,530	70.00	30.426	\$280
	2082	\$5,669	71.00	31.948	\$177
13	2083	\$3,685	72.00	33.545	\$110
	2084	\$2,338	73.00	35.222	\$66
14	2085	\$1,442	74.00	36.984	\$39
	2086	\$862	75.00	38.833	\$22
15	2087	\$497	76.00	40.774	\$12
	2088	\$276	77.00	42.813	\$6
16	2089	\$146	78.00	44.954	\$3
	2090	\$73	79.00	47.201	\$2
17	2091	\$35	80.00	49.561	\$1
	2092	\$15	81.00	52.040	\$0
18	2093	\$6	82.00	54.641	\$0
	2094	\$2	83.00	57.374	\$0
19	2095	\$1	84.00	60.242	\$0

TOTAL PRESENT VALUE \$242,803,600

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